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# CORRUPT OVERSEAS PAYMENTS BY U.S. BUSINESS ENTERPRISES

JULY 2, (legislative day, JUNE 18), 1976.—Ordered to be printed

Mr. PROXMIRE, from the Committee on Banking, Housing and Urban Affairs, submitted the following

## REPORT

[To accompany S. 3664]

The Committee on Banking, Housing and Urban Affairs favorably reports a Committee bill (S. 3664) to amend the Securities Exchange Act of 1934 to require issuers of securities registered pursuant to section 12 of such act to maintain accurate records, to prohibit certain bribes, and for other purposes, and recommends that the bill do pass.

*I. History of the Legislation*

The Committee held hearings on improper overseas payments April 5, 7, 8, and May 18, 1976, as well as earlier hearings on the Lockheed loan guarantee and alleged bribes by the Lockheed Company.

The Committee considered several proposed remedial measures:

S. 3133, introduced by Senator Proxmire March 11, 1976;

S. 3379, introduced by Senators Church, Clark and Pearson May 5, 1976; and

S. 3418, introduced by Senator Proxmire at the request of the Securities and Exchange Commission (SEC) May 12, 1976.

The Committee also received from the SEC an extensive Report On Questionable and Illegal Corporate Payments and Practices, dated May 12, 1976 summarizing the SEC's enforcement program to date under existing law ("SEC Report"). The Report analyzed public filings of 89 corporations disclosing varying types of questionable payments, plus six special reports obtained as the result of SEC enforcement actions and the alegations made in eight additional cases in which the SEC obtained judicial relief. The Report also contains the SEC's analysis of the degree of disclosure required under the materiality doctrine of the securities laws where questionable foreign payments are made.

57-010

On June 12, 1976, the Committee received interim recommendations from Secretary of Commerce Richardson, on behalf of President Ford's Cabinet-level Task Force on Questionable Corporate Payments Abroad. ("Task force")

Senate bill 3133, as introduced, would authorize the SEC to issue regulations requiring issuers of registered securities to keep accurate books and records. It would require such issuers to report to the SEC all payments in excess of $1000 regardless of any corrupt purpose, to foreign officials, political parties, or sales agents retained in connection with obtaining business from, or influencing legislation or regulations of, a foreign government. The bill would also prohibit payments to foreign officials, parties, or intermediaries where the payment was intended to influence legislation, regulations, or to obtain business.

Senate bill 3379 would require issuers of registered securities to file with the SEC reports describing foreign political contributions, payments to foreign officials intended to influence their decisions, and payments to commercial purchasers or sellers intended to influence normal business decisions. Such issuers and their foreign agents would be required to keep books on such transactions for at least five years. In addition, S. 3379 provies for an annual foreign policy analysis by the State Department on foreign policy implications of questionable payments. The bill provides for disclosure of some information directly to shareholders. In addition, S. 3379 would amend the Internal Revenue Code to prohibit deductions for illegal payments. The bill also requires companies to establish audit committees made up of their outside directors, constituting at least one-third of the total board membership. The bill would create new private rights of action by shareholders or competitors injured by the payment of bribes, and would mandate the President to seek international agreements to inhibit improper payments.

Senate bill 3418 requires issuers of registered securities to keep accurate books and records, and to devise and maintain an adequate system of internal accounting controls; it makes its unlawful to falsify books or records, or to deceive an accountant in connection with an audit.

The Richardson Task Force proposal, which was not in legislative form at the time the Committee met, recommended generally a disclosure scheme to require disclosures by all domestic companies of payments in excess of some floor amount made in connection with obtaining or maintaining business with a foreign government. The amount, purpose, and recipient of the payment would be described in reports filed with to an executive branch department, probably the Department of State or Commerce and not the SEC, to be made public after a delay of up to a year. The task force also recommended enactment of the SEC accounting proposal, S. 3418.

The Committee met June 22, 1976 and favorably reported a clean bill which incorporates verbatim all of S. 3418, and a narrowly defined direct criminal prohibition against the payment of overseas bribes by any U.S. business concern.

*II. Summary of the Legislation*

Section 1. This section adopts the recommendations of the SEC. It requires reporting companies to create and to maintain accurate books and records. Secondly, it requires internal accounting controls suffi-

cient to assure that transactions will be executed in accordance with management's instructions, that transactions will be accurately recorded, that access to corporate assets is carefully controlled, and that the representations on company books will be compared at reasonable intervals with actual assets, and any discrepancies resolved. This section also makes it a crime for a reporting company to falsify books, records, accounts, or documents, or to deceive an accountant in connection with an examination or audit.

Section 2. This section applies to corporations subject to the jurisdiction of the SEC by virtue of the reporting requirements of the Securities Exchange Act of 1934. It applies the existing criminal penalties of the securities laws (up to two years imprisonment and a fine of up to $10,000) for payments, promises of payment, or authorization of payment of anything of value to any foreign official, political party, candidate for office, or intermediary, where there is a corrupt purpose. The corrupt purpose must be to induce the recipient to use his influence to direct business to any person, to influence legislation or regulations, or to fail to perform an official function in order to influence business decisions, legislation, or regulations, of a government.

Section 3. This section applies the identical prohibitions and penalties provided by Section 2 to any domestic business concern other than one subject to the jurisdiction of the SEC pursuant to Section 2. Violations of the criminal prohibition under Section 3 by persons not subject to SEC jurisdiction would be investigated and prosecuted by the Justice Department. Violations under Section 2 would normally be investigated initially by the SEC, but referred for criminal prosecution to the Justice Department.

*III. Need for the Legislation*

There is a broad consensus that the payment of bribes to influence business decisions corrodes the free-enterprise system. Bribery short-circuits the marketplace. Where bribes are paid, business is directed not to the most efficient producer, but to the most corrupt. This misallocates resources and reduces economic efficiency.

More importantly, bribery is simply unethical. It is counter to the moral expectations and values of the American public, and it erodes public confidence in the integrity of the free market system. Bribery of foreign officials by some U.S. companies casts a shadow on all U. S. companies. It puts pressure on ethical enterprises to lower their standards and match corrupt payments, or risk losing business.

When bribery is exposed, it usually leads to sanctions both by the host government and the marketplace, against the offending company. The results have included cancellation of contracts, expropriations fines, lawsuits, and a loss of confidence in the company by investors.

Bribery of foreign officials by U.S. corporations also creates severe foreign policy problems. The revelations of improper payments invariably tends to embarass friendly regimes and lowers the esteem for the United States among the foreign public. It lends credence to the worse suspicions sown by extreme nationalists or Marxists that American businesses operating in their country have a corrupting influence on their political systems. It increases the likelihood that when an angry citizenry demands reform, the target will be not only the

corrupt local officials, but also the United States and U. S. owned business.

Bribery by U. S. companies also undermines the foreign policy objective of the United States to promote democratically accountable governments and professionalized civil services in developing countries.

*IV. Arguments Against the Legislation Are Unconvincing*

While most witnesses before the Committee denounced bribery as an intolerable practice, the argument is sometimes made that U.S. companies must pay bribes in order to compete with less scrupulous foreign competitors. As late as 1975, a survey of senior executives of major companies revealed that nearly half condoned bribery as necessary to do business in some parts of the world.

In reality, however, many of America's leading companies have never resorted to bribery. A number of corporate chief executive officers have spoken out forcefully against bribery and have devised management controls to ensure that bribes are not paid. SEC Chairman Hills told the Committee in testimony May 18, "We find in every industry where bribes have been revealed that companies of equal size are proclaiming that they have no need to engage in such policies."

Indeed, there is substantial evidence that a refusal to bribe seldom results in a business advantage for foreign competitors. As Secretary Richardson observed on behalf of the Administration Task Force, "In a multitude of questionable payments cases—especially those involving sales of military and commercial aircraft—payments have been made not to outcompete foreign competitors, but rather to gain a competitive edge over other U.S. manufacturers."

A strong anti-bribery law would help U.S. multinational companies resist corrupt demands, and would enhance the reputation of U.S. business abroad. The former Chairman of Gulf Oil Company, Bob Dorsey, commented in testimony before the Multinationals Subcommittee of the Senate Foreign Relations Committee:

> . . . such a statute on our books would make it easier to resist the very intense pressures which are placed on us from time to time. If we could cite our law which says that we just may not do it, we would be in a better position to resist these pressure and refuse the requests.

The argument has also been made that some foreign countries might resent American attempts to export our morality and impose American standards on transactions taking place in their countries. The fact is that virtually every country has its own laws against bribery, although some are not vigorously enforced. Given world-wide outcry against the corrupting influence of some United States-based multinationals on foreign governments, the Committee believes that most countries would welcome a greater effort by the United States to discourage offensive conduct by U.S. companies, wherever their activities may take place.

The Attorney General of the African Republic of Botswana, Mr. M. D. Mokama, has observed:

> Certainly, no self-respecting African nation would consider U.S. legislation aimed at curbing corrupt practices of Ameri-

> can transnational enterprises in their foreign host states to be "presumptous" or in any way "an interference". On the contrary, most Third World nations would appreciate such legislation. You see, developing countries have difficulties in discovering offenses commited by U.S. corporations in so far as their bribing and corrupting of local government officials . . . Why do you think all of these disclosures are coming out of Washington and not out of the host countries? On this particular issue, most Third World countries would want to cooperate to the fullest extent possible, with the U.S. and other home countries to make sure that the offending transactional enterprise is punished. Another result of the U.S. adopting such legislation is that the Third World will acquire a healthier respect for the United States and its transnational enterprises.

The concern has also been raised that criminal sanctions against an illegal act which takes place at least in part outside the United States, even if desirable, may be unenforceable or unconstitutional. It is a settled question of international law, of course, that a state may regulate the conduct of its citizens overseas where such conduct has consequences domestically.

There are ample legal precedents for the prosecution of criminal conduct overseas, where the illegal act is commited by a U.S. citizen or national or by a U.S. organized or controlled company, where there is a nexus between that act and acts carried out within the United States, or where the act has consequences in the United States. Examples include securities fraud, violations of the Trading With The Enemy Act, and certain anti-trust violations. This Report includes a legal memorandum on that point. Moreover, in the current SEC investigations of violations of the securities laws involving failure to disclose material payments, the SEC has referred cases to the Justice Department for prosecution where the alleged criminal violation involved failure to report an overseas payment.

The Committee also notes that in most cases investigated by the SEC to date, investigators were able to uncover adequate evidence of overseas payments by subpoenaing records, and/or interviewing witnesses with knowledge of such payments, available in the United States. Furthermore, ethical employees or competitors are often a source of information on bribes paid overseas. All of these sources will continue to be available in the prosecution of bribery cases.

Finally, while the Committee recognizes that the Securities and Exchange Commission has diligently sought to enforce the securities laws provisions requiring corporate reports to disclose "material" payments, the concerns raised by the disclosure of corrupt foreign payments require a national policy against corporate bribery that transcends the narrower objective of adequately disclosing material information to investors.

Secretary Richardson, speaking for the Administration, Chairman Hills, on behalf of the SEC, and Senator Church, Chairman of the Multinationals Subcommittee, all advised the Committee that additional legislation is necessary.

Observing that "the almost universal characteristic of the cases reviewed to date by the Commission has been the apparent frustration of our system of corporate accountability," Chairman Hills urged the Committee to support legislation requiring stricter accounting requirements for large publicly-held companies; and the SEC proposal has been incorporated in the bill as reported.

Secretary Richardson commented that the SEC in relying on the disclosure requirements of the securities law to reach the corrupt payments problem, had stretched the materiality doctrine to its limits. He concluded that existing statutes are "insufficient to deal adequately with the questionable payment problem."

While some sentiment has been expressed in favor of reliance on multilateral remedies, the Committee recognizes that pending multilateral measures are largely hortatory in nature and do not include reliable enforcement machinery or sanctions for violators. The recent OECD code of conduct, for example, provides that "Enterprises should not render—nor should they be solicited or expected to render—any bribe or other improper benefit, direct or indirect to any public servant or holder of public office."

While this code might prove marginally useful, the Committee notes that bribery of public officials is already illegal under the laws of most countries. Clearly, where countries do not vigorously enforce their domestic bribery laws, there is little likelihood that a redundant, voluntary code will have significant impact.

In order to facilitate enforcement of the proposed anti-bribery statute, the Committee does expect the State Department to continue efforts to negotiate treaties and bi-lateral agreements providing specific cooperative law enforcement arrangements, including exchange of information and records, and extradition of fugitives. Binding bilateral enforcement agreements will produce more results than voluntary codes.

The Committee firmly believes, nonetheless, that an American anti-bribery policy must not await the perfection of international agreements however desirable such arrangements may be. As former Undersecretary of State George Ball testified:

> I don't think the United States is going to get very far in seeking (an anti-bribery treaty) unless we first take measures ourselves. Then I think we can speak with some authority.

*V. What is a Prohibited Bribe*

The bill as reported prohibits payments, promises to pay, or authorizations of payments to foreign officials, candidates or parties corruptly intended to involve the recipient to use his influence to secure business, influence legislation or regulations.

In drafting the bill, as reported, the Committee deliberately cast the language narrowly, in order to differentiate between such payments and low-level facilitating payments sometimes called "grease payments."

Thus, Sections 2 and 3 would not reach a small gratuity paid to expedite a shipment through Customs or the placement of a trans-Atlantic telephone call, to secure required permits, or to ensure that a corporation's warehouses were not put to the torch. In other words,

payments made to expedite the proper performance of duties may be reprehensible, but it does not appear feasible for the United States to attempt unilaterally to eradicate all such payments. However, where the payment is made to influence the placement of government contracts or to influence the formulation of legislation or regulations, such payment is prohibited.

The prohibitions contained in Sections 2 and 3 cover payments and gifts intended to influence the recipient, regardless of who first suggested the payment or gift. The defense that such a payment was extorted would not suffice, since at some point the U.S. company would make a decision whether to pay the bribe. That the payment may have been first proposed by the recipient rather than the U.S. company does not alter the corrupt purpose on the part of the person paying the bribe.

The word "corruptly" is used in order to make clear that the offer, payment, promise, or gift, must be intended to induce the recipient to misuse his official position in order to wrongfully direct business to the payor or his client, or to obtain preferential legislation or regulation. The word "corruptly" connotes an evil motive or purpose such that as required under 18 USC 201(b), which prohibits domestic bribery. As in 18 USC 201(b), the word "corruptly" indicates an intent or desire to wrongfully influence the recipient. It does not require that the act be fully consummated, or succeed in producing the desired outcome.

The Committee fully recognizes that the proposed law will not reach all corrupt payments overseas. For example, Sections 2 and 3 would not permit prosecution of a foreign national who paid a bribe overseas acting entirely on his own initiative. The Committee notes, however, that in the majority of bribery cases investigated by the SEC, some responsible official or employee of the U.S. parent company had knowledge of the bribery and approved the practice. Under the bill as reported, such employees could be prosecuted. The concepts of aiding and abetting and joint participation in, would apply to a violation under this bill in the same manner in which they have applied in both SEC actions and in private actions brought under the securities laws generally.

Furthermore, any U.S. corporation subject to the accounting requirements of Section 1 which made a practice of "looking the other way" in order to be able to raise the defense that they were ignorant of bribes initiated by a foreign subsidiary, could be in violation of new subparagraph (b) (2) (B) requiring issuers to devise and maintain adequate accounting controls. Under Section 1, no off-the-books account or fund could lawfully be maintained, either by the U.S. parent or by its foreign subsidiary, and no improper payment could be lawfully disguised.

The Committee expects that the prohibitions contained in Section 2 of the bill as reported will complement the accounting provisions of Section 1, which were recommended by both the SEC and the Richardson task force. The Committee took note of the SEC's oft-repeated conclusion that "virtually all questionable payment matters have involved the deliberate falsification of corporate books or records, or the maintenance of inaccurate or inadequate books and records, which,

among other things, prevent these practices from coming to the attention of the company's auditors, outside directors, and shareholders."

The Committee expects that the requirement to maintain accurate books records, and management controls and the prohibition against falsifying such records or deceiving an auditor, will go a long way towards eliminating improper payments, which—almost by definition—require concealment. Taken in combination with the criminal prohibition against bribery, the accounting provisions should be adequate to the task of detering corrupt payments even where transgressors take steps to evade the intent of the law.

*VI. Prohibition vs. Disclosure*

The Committee considered two approaches for curbing the kind of bribery payments to foreign officials defined under Section 2 and 3 of the bill. One approach would be to require that these bribes be publicly disclosed. The other approach would be to prohibit them by law with criminal penalties for those who violate the law.

The disclosure approach was contained in S. 3379 and recommended by the Cabinet Task Force chaired by Secretary Richardson. The Task Force report to the Committee argued that disclosure would constitute an effective deterrant whereas an outright criminal prohibition would be difficult to enforce.

The Committee carefully weighed these arguments and decided that a direct criminal prohibition is the better approach. As the Richardson Task Force itself pointed out, a direct criminal prohibition of foreign bribes "would represent the most forceful possible rhetorical assertion by the President and the Congress of our abhorrence of such conduct. It would place business executives on clear and unequivocal notice that such practices should stop. It would make it easier for some corporations to resist pressures to make questionable payments." On the other hand, merely requiring the disclosure of bribes would leave ambiguous whether such payments might be acceptable. Indeed, it would imply that bribery can be condoned as long as it is disclosed.

The Committee considered whether a criminal prohibition might be more difficult to enforce than a disclosure requirement. The Committee concluded that an outright prohibition would be at least as feasible to enforce as any meaningful disclosure requirement.

Under the disclosure approach recommended by Secretary Richardson all payments made to foreign officials for the purpose of "obtaining or maintaining business with or influencing the conduct of a foreign government" would have to be disclosed. Clearly, in order to enforce such a disclosure requirement and apply sanctions for failure to file reports, it would be necessary to prove that the undisclosed payment was actually made, and that it was made with an improper purpose. Thus, the same evidence necessary to prove a violation of a direct prohibition would have to be marshalled in order to enforce a disclosure statute. Beyond that, there would be the additional burden of proving that an issuer willfully failed to file a report describing the bribe.

Accordingly, the Committee concluded that a disclosure approach has at least the same enforcement problems inherent in the direct prohibition approach and none of its advantages. The bill, as reported, therefore, provides a direct criminal prohibition.

*VII. Disclosure of Potentially Questionable Payments*

Having decided in favor of a direct criminal prohibition of bribery payments as narrowly defined under section 2 and 3 of the bill, the Committee also considered whether to require the disclosure of other payments which might not meet the narrow definition of a bribe but which might be nonetheless potentially questionable. These include all payments to foreign officials regardless of purpose, contributions to foreign political parties, and payments to foreign sales agents, many of whom act essentially as influence peddlers. The disclosure of such payments was required under S. 3313, S. 3379, and possibly under the proposals of the Richardson Task Force although the Committee has not yet received the precise legislative language to be recommended by the Task Force.

A requirement to disclose all payments to foreign officials regardless of purpose, contributions to foreign political parties and payments to foreign sales agents would have the effect of deterring those payments which are dubious in purpose but which may not meet the bill's definition of an illegal bribe. For example, the payment of an extraordinarily large sales commission to a foreign sales agent would not be illegal unless the U. S. government could prove that the company making the payment actually knew or had reason to know that part of the payment would be passed on to a foreign official to influence his conduct. However, if the payment had to be publicly disclosed, the company involved might face embarassing questions from its stockholder and directors and the press. A disclosure requirement would thus tend to discourage those payments that cannot be justified to the public while permitting those that are legitimate and proper to take place. The ultimate test of propriety would be the weight of public opinion.

These benefits must be balanced against the cost of disclosure. For example, a requirement to disclose all sales commissions to foreign sales agents would involve the disclosure of payments that are perfectly legitimate and proper as well as those that might be questionable. The Committee did not have enough information to determine whether the benefits of a disclosure program would outweigh its cost. Accordingly, the Committee decided to postpone action on the disclosure provisions of S. 3133 and S. 3379 until more information could be obtained as to their costs and benefits.

*VII. Enforcement responsibilities*

The Committee accepted Secretary Richardson's recommendation that anti-bribery legislation should not be limited merely to companies currently subject to SEC jurisdiction, since some 20,000 large and small U. S. based exporters are not currently subject to SEC reporting requirements. Under Section 3 of the bill, any U. S. based business concern not subject to the SEC's reporting requirements would be prohibited from making proscribed payments.

The jurisdiction of the Justice Department under Section 3 of the bill would be limited by the definition of the term "domestic concern". Paragraph (c)(1) defines the term to mean an individual who is a citizen or national of the United States and any corporation, partnership, association, joint-stock company, business trust, or incor-

porated organization which (1) is owned or controlled by individuals who are United States Citizens or nationals, (2) has its principal place of business in the United States, or (3) is organized under the laws of any State, territory, possession, or commonwealth of the United States.

The Committee recognizes that principles of international law and comity generally operate to preclude a nation from establishing laws applicable to conduct which takes place outside that country's territorial boundaries. However, it is clear that a nation may adopt and enforce laws covering foreign conduct of its own nationals and covering foreign conduct which has significant effects within that nation. See American Law Institute, Restatement (Second) of the Law of Foreign Relations of the United States, Ch. 2 (1965) and *Steele* v. *Bulova Watch Co.*, 344 U.S. 280 (1952).

In the case of companies that currently file reports with the SEC, the Committee concluded that the SEC should retain jurisdiction. This is provided in Section 2 of the bill, which amends the Securities Exchange Act of 1934.

The SEC's responsibilities would be limited to conducting investigations, bringing civil actions, and referring cases to the Justice Department for criminal prosecution where warranted, just as the Commission currently refers alleged criminal violations of the securities laws to the Justice Department for prosecution. The Committee belives that Sections 1 and 2 will enhance the SEC's existing enforcement efforts, and will provide additional enforcement remedies. The SEC, of course, will retain all of its existing remedies under the securities laws, and the Committee anticipates that the Commission will continue to tailor remedies to fit the circumstances of specific cases.

Retaining SEC jurisdiction in the case of reporting companies will avoid a costly duplication of effort, which would result if enforcement of the anti-bribery statute were made the sole responsibility of the Justice Department. The SEC already has an experienced enforcement staff with considerable knowledge of the foreign bribery area. Since the kind of foreign bribe prohibited by the bill would usually be a material fact to investors, the SEC's enforcement staff has a continuing responsibility in this area whether or not bribes are made illegal per se under the 1934 Act.

Under the existing SEC enforcement program, in many cases the threat of criminal prosecution (for failure to make material disclosures) has induced management to cooperate with the SEC's so-called voluntary disclosure program. The Committee expects that a direct prohibtion would give the SEC additional effective tool for deterring future improper conduct, since an offender would risk prosecution not just for failure to report a payment where the payment would be shown to be material, but also for making the proscribed payment directly.

The Committee believes that by assigning the SEC enforcement responsibilities for the criminal prohibition, it will strengthen the Commission's ability to enforce compliance with the existing requirements of the securities laws, and with the new accounting provisions

recommended by the SEC and included as Section 1 of the bill. The Committee, therefore, deems it advisable to give the SEC jurisdiction over the new anti-bribery provisions as they affect reporting companies.

Obviously, there may be practical impediments to enforcement in individual cases, just as proof of bribery and other white collar crimes is often difficult to obtain in domestic cases. Nonetheless, the SEC's enforcement efforts under existing U.S. law demonstrate that it is entirely feasible for U.S. agencies to successfully investigate improper foreign payments made on behalf of American corporations.

*VIII. Accurate Accounting*

Section 1 of the bill as reported amends Section 13(b) of the Securities Exchange Act, 15 U.S.C. 78m (b), by adding new paragraphs (b)(2), (b)(3), and (b)(4).

Paragraph (b)(2) would apply to issuers which have securities listed on an exchange pursuant to Subsection 12(b) of the Securities Exchange Act, 15 U.S.C. 781(b), to issuers which meet the requirements of subsection 12(g) of that Act, 15 U.S.C. 781(g), and to issuers subject to the reporting requirement of subsection 15(d) of the Act, 15 U.S.C. 780(d). Subparagraph (b)(2)(A) imposes an obligation on these issuers to maintain books and records that accurately and fairly reflect the transactions and dispositions of the assets of the issuers.

The Securities and Exchange Commission has noted that an "almost universal characteristic of the cases" it has reviewed "has been the apparent frustration of our system of corporate accountability." According to the Commission, "millions of dollars of funds have been inaccurately recorded in corporate books and records."

While the Committee believes that the requirement that issuers maintain books, records, and accounts that accurately and fairly reflect the transactions and dispositions of the assets of the issuer is implicit in the existing securities laws, the Committee believes that such a basic requirement should be explicit.

Concern has been expressed that the use of the word "accurately" may connote a degree of exactitude that is unrealistic. The Committee does not agree. The term "accurately" in the bill does not mean exact precision as measured by some abstract principle. Rather, it means that an issuer's records should reflect transactions in conformity with accepted methods of recording economic events. Thus, for example, recording depreciation in a manner permitted by the Internal Revenue Code may not be a precise measurement, but it is nevertheless clearly a permissible one within the intent of subparagraph (2).

Subparagraph (b)(2)(B) would require issuers to devise and maintain an adequate system of internal accounting controls sufficient to provide reasonable assurances that, among other things, transactions are recorded as necessary to permit the preparation of financial statements in conformity with generally accepted accounting principles or any other applicable criteria. Because the accounting profession has defined the objectives of a system of accounting control, the definition of the objectives contained in this subparagraph is taken from the authoritative accounting literature.

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS, STATEMENT ON AUDITING STANDARDS NO. 1, 320.28 (1973)

Requiring companies to devise, establish, and maintain an adequate system of internal accounting controls is not a panacea. Likewise it is not a requirement that is intended to be enforced without regard to the point at which the costs associated with a particular corporate system of internal accounting controls exceeds the benefits that flow from that system. The accounting profession will be expected to use their professional judgment in evaluating the systems maintained by issuers.

The Committee understands that auditors customarily provide management comments on the state of their internal controls. These comments are designed to assist the issuer in improving its system of internal controls and thereby to assist the auditor in the conduct of its audit. The Committee recognizes that no system of internal controls is perfect and that there will always be room for improvement. Auditors' comments and suggestions to management on possible improvements are to be encouraged.

Paragraph (b)(3) of the bill would make it unlawful for any person, directly or indirectly, to falsify any book, record, account or document maintained, or required to be maintained, for an accounting purpose with respect to each of the three classes of issuers subject to subsection (b)(2) of Section 13 of the Securities Exchange Act of 1934, 15 U.S.C. 78m(b). This subsection covers both acts of commission and omission. Concepts of aiding and abetting, and joint participation in, a violation would be applicable under this provision in the same manner as they traditionally have applied in both Commission actions and private actions brought under the securities laws generally.

Paragraph (b)(4) would prohibit making false or misleading statements or omitting to state facts necessary to be stated to an accountant in connection with any audit or examination of the three classes of issuers identified in subsection (b)(2) of Section 13 of the Securities Exchnage Act. This paragraph would also apply to audits in connection with a securities offering registered or to be registered under the Securities Act of 1933. As with subsection (b)(3) of the proposal discussed above, aiding and abetting and joint participation would constitute actionable conduct under this provision. By specifically prohibiting material false or misleading statements or omissions to state material facts to auditors, the bill is designed to encourage careful communications between the auditors and persons from whom the auditors seek information in the audit process. The Committee does not believe that this provision will inhibit such communications and intends that this prohibition is to be directed only at those who fail to exercise due care in furnishing information to auditors engaged in an audit, a standard that we believe represents what is customarily expected in normal commerce.

*IX. Other Remedial Measures*

As introduced, S. 3379 included two provisions creating new private rights of action for persons injured by the payment of bribes. The Committee deleted the provision in Section 9 of S. 3379 creating a new shareholder's right of action, largely because the Committee believes

that this would have duplicated and possibly confused existing remedies available to shareholders.

The Committee found merit in Section 10, which proposed a private cause of action for any person who could establish actual damage to his business resulting from illegal payments made by a competitor. As drafted, however, Section 10 created ambiguities. Rather than delay the reporting of the bill, the Committee requested the staff to devise more acceptable language. The Committee may offer a floor amendment relating to competitors rights of action.

The Committee's decisions thus far with respect to private causes of action for competitive damage and for violations of the securities laws were not intended, nor should our decisions be construed to have, any effect on existing law concerning private causes of action under the present federal securities laws.

SECTION-BY-SECTION ANALYSIS

The purposes of this legislation would be acomplished by amending existing section 13(a) of the Securities Exchange Act of 1934 (the "Exchange Act"), by adding a new section 30A to the Exchange Act, and by adding a new provision to the criminal code.

*Section 1*

This section of the bill as reported would amend section 13 of the Exchange Act by renumbering existing paragraph (b) as (b)(1) and by adding three new paragraphs.

New subparagraph 13(b)(2) would apply only to issuers which have a class of securities registered pursuant to section 12 of the Exchange Act and issuers required to file reports pursuant to section 15(d) of the Exchange Act ("reporting companies"). It would require reporting companies to make and keep books, records and accounts which accurately and fairly reflect all of their transactions and dispositions of the assets.

A reporting company also would be required to establish and maintain an adequate system of internal accounting controls sufficient to provide reasonable assurances that transactions are executed in accordance with management's directions and that they be recorded in a manner that permits the company to prepare its financial statement in accordance with generally accepted accounting principles or other applicable criteria and maintain accountability for its assets. The system of accounting controls also would have to be sufficient to assure that access to a company's assets is permitted only in accordance with management's authorization and that the recorded accountability for assets is compared with its existing assets at reasonable intervals and appropriate action is taken with respect to differences.

New subparagraph 3 would make it unlawful for any person to falsify or cause to be falsified any book, record, account or document of a reporting company which has been made or is required to be made for any accounting purpose.

New subparagraph 4 would make it unlawful for any person to make or cause to be made a materially false or misleading statement or to omit to state or cause another person to omit to state any mate-

rial fact necessary in order to make statements to an accountant not misleading. This provision would apply to statements made to an accountant in connection with any examination or audit of an issuer with securities registered or to be registered under the Securities Act of 1933, as well as any examination or audit of a reporting company.

*Section 2*

Section 2 of the bill as reported would add a new section 30A to the Exchange Act to prohibit any reporting company from offering, paying, promising to pay or authorizing the payment of any money and from offering, giving, promising to give or authorizing the giving of anything of value, for a corrupt purpose, to three classes of persons:

(1) to an official of a foreign government or instrumentality of a foreign government,

(2) to a foreign political party or an official of a foreign political party, or a candidate for a foreign political office, and

(3) to any other person while the issuer knows or has reason to know that money or a gift will be offered, promised or given to an official of a foreign government or instrumentality, a foreign political party, an official of a foreign political party, or a candidate for a foreign political office.

The scope of Section 30A is further limited by the requirement that the offer, promise, authorization, payment or gift have as a purpose inducing the recipient to use his or its influence with the foreign government or instrumentality, or to refrain from performing any of his or its official responsibilities, so as to direct business to any person, maintain an established business opportunity with any person, divert any business opportunity from any person or influence the enactment or promulgation of legislation or regulations of that government or instrumentality.

*Section 3*

Section 3 of the bill as reported would prohibit persons included in the definition of the term "domestic concern" who would not be covered by new section 30A of the Exchange Act from engaging in any of the same types of conduct prohibited by that section.

The term "domestic concern" is defined in the bill to mean an individual who is a citizen or national of the United States as well as any corporation, partnership, association, joint-stock company, business trust, or unincorporated organization which is owned or controlled by individuals who are citizens or nationals of the United States, which has its principal place of business in the United States, or which is organized under the laws of a State of the United States or any territory, possession, or commonwealth of the United States.

The term "interstate commerce" is defined to mean trade, commerce, transportation, or communication among the several States, or between any foreign country and any State, or between any State and any place or ship outside thereof. The term includes the intrastate use of a telephone or other interstate means of communication and the intrastate use of any other interstate instrumentality.

The penalties for each violation of this provision would be the same as the criminal penalties contained in the Exchange Act—a fine of up to $10,000 or imprisonment for up to two years, or both.

COST OF THE LEGISLATION

In compliance with Section 252(a)(1) of the Legislative Reorganization Act of 1970, as Amended, the Committee estimates that there will be no substantial additional costs incurred in carrying out the provisions of this legislation.

WAIVER OF CORDON RULE

In the opinion of the Committee it is necessary to dispense with the requirements of subsection 4 of rule XXIX of the Standing Rules of the Senate in order to expedite the business of the Senate.

MEMORANDUM FOR SENATOR PROXMIRE

This memorandum is transmitted in response to the request by Mr. Robert Kuttner, a member of the staff of the Committee on Banking, Housing and Urban Affairs, for my opinion concerning two comments made during the hearings before the Committee on Banking, Housing and Urban Affairs on your bill (S. 3133) to amend the Securities Exchange Act of 1934 to require issuers of securities registered pursuant to section 12 of such Act to maintain accurate records and to furnish reports relating to certain foreign payments, and for other purposes. I understand that the two comments were that—

(1) The bill may have extraterritorial applicability beyond the reach of the legislative power of the United States; and

(2) The bill presents insurmountable problems of administration and enforcement.

The major substantive provision of S. 3133 which may be subject to either of the above comments is contained in section 3 of the bill which amends the Securities Exchange Act of 1934 to prohibit an issuer of securities registered pursuant to section 12 of the Act from making use of the mails or of any means or instrumentality of interstate commerce to pay or offer or agree to pay sums of money to certain individuals or to foreign governments or officials.

I.—EXTRATERRITORIALITY

A. *International law.*—There are a number of theories of legislative jurisdiction under international law. *See generally*, American Law Institute, Restatement (Second) of the Law of Foreign Relations of the United States, ch. 2 (1965) (hereinafter referred to as the "Restatement"). The first and most familiar of these theories is the territorial principle. Under this principle, a nation may prescribe rules of law attaching legal consequences to conduct occurring within its territory, whether or not the effect of that conduct falls within the territory. The territorial principle is the principle of law on which the Congress is deemed to rely absent a specific indication of legislative intent to apply the statutory precriptions extraterritorially. *American Banana Co.* v. *United Fruit Co.*, 213 U.S. 347 (1909). It is apparently the familiarity of this principle which underlies the first comment.

There are, however, several additional, though less familiar, jurisdictional theories which may have some applicability to the bill before

the Banking Committee. The first and perhaps most familiar of these theories gives a nation jurisdiction to prescribe rules of law relating to conduct occurring beyond its territorial limits if that conduct has its effect within the territory of the prescribing nation. This jurisdiction is limited to cases where (1) the conduct and the effect of that conduct are generally recognized as constituent elements of a crime or a tort, (2) the effect within the territory is substantial, and (3) the effect is a direct and foreseeable result of the extraterritorial conduct. In addition, the exercise of this jurisdiction is limited to those cases where such exercise is not inconsistent with generally recognized principles of justice. Restatement § 18.

A third theory of international legal jurisdiction holds that a nation has jurisdiction to prescribe rules of law relating to the conduct of its nationals, wherever that conduct occurs. For the purpose of the exercise of this type of jurisdiction, a corporation has the nationality of the nation which creates it. Thus, any corporation chartered by a State of the United States would be deemed to be a national of the United States, and the exercise of jurisdiction over nationals would apply to any such issuer. Restatement § 27. The exercise of this jurisdiction may be limited where the substantive law under the territorial jurisdiction of the foreign state conflicts with the law of the nation exercising jurisdiction over the national. Restatement § 30. This jurisdictional theory apparently was relied upon in part by the Supreme Court in the decision in *Steele* v. *Bulova Watch Co.*, 344 U.S. 280 (1952), in which the trademark law of the United States was held to be applicable to the conduct of a United States citizen in Mexico.

B. *Constitutional law.*—The limits of the authority of the Congress under the Constitution to prohibit acts committed in foreign countries has not been defined with any degree of precision by the courts. While the Constitution expressly imposes no such limitations, the cases I have examined indicate a reluctance in the courts to express any doctrine more extensive than required by the cases before them. Thus, the cases are generally resolved on the basis of statutory interpretation rather than through the application of constitutional doctrine. An example again is the opinion in the *American Banana* case, referred to above.

In other cases, where the intent of Congress to apply the statute extraterritorially was clear, the results have sustained the exercise of extraterritorial jurisdiction. For example, in *United States* v. *Bowman*, 260 U.S. 94 (1922), the Supreme Court reversed a lower court order quashing an indictment against an American citizen for conspiracy to defraud a corporate instrumentality of the United States even though the acts specified in the indictment had occurred outside the United States, and the statute did not expressly reach extraterritorial violations. In *Blackmer* v. *United States*, 284 U.S. 421 (1932), the court upheld the imposition of fines on an individual for a contemptuous failure to respond to a subpoena issued by a district court, even though service of the subpoena was made in France. In reaching its result, the Court relied upon other instances of the exercise of United States extraterritorial jurisdiction over its citizens, specifically citing the applicability of the income tax laws to United States citizens abroad.

On the basis of these authorities, I have concluded that there is no general limitation under either international law or the Constitution on the authority of Congress to prescribe rules of conduct for citizens or nationals of the United States abroad. There has been, however, little in the way of direct case law authority on this subject, and a determination in a case arising under the language of your bill might turn on the particular facts of that case, such as whether the issuer involved is in fact a national of the United States or whether the payment made in a foreign country has an effect on the securities markets in the United States or on holders of the securities of that issuer who are nationals of the United States.

II.—ADMINISTRATION AND ENFORCEMENT

The comment that the bill as drafted presents insurmountable problems of administration and enforcement is more difficult to respond to. First, I think that the bill would be difficult to enforce, especially in the context of a criminal prosecution. The availability of witnesses and evidence in a case the essential elements of which take place abroad would probably be so limited as to preclude proof beyond a reasonable doubt, the standard in a criminal case. If criminal prosecution were the only means of enforcement of the statute, then the second comment would have to be demurred to.

However, because your bill amends the Securities Exchange Act of 1934, it provides the Securities and Exchange Commission with a variety of administrative and civil enforcement tools available under that Act which give the Commission authority and flexibility to address violations of the statute without having to prove any violation beyond a reasonable doubt. Therefor, I do not believe that the bill, as drafted, is impossible to enforce or administer. However, the Commission itself may wish to provide you with a fuller response to any questions relating to any problems of administration or enforcement of the bill.

Respectfully submitted,

FRANK BURK,
*Assistant Counsel.*

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JOURNAL

OFFICE OF LEGISLATIVE COUNSEL

Thursday - 16 September 1976

STAT

[redacted]

2. (Unclassified - SK) EMPLOYMENT Received a call from Mr. Hamberger, in the office of Senator Hugh Scott (R., Pa.), requesting an interview with a recruitment officer for [redacted] STAT STAT

[redacted]

Mr. Hamberger was notified of the arrangement.

3. (Unclassified - DFM) LIAISON Called Bill Miller, Staff Director, Senate Select Committee on Intelligence, and verified he had not spoken to any members of the Committee regarding speaking to an upcoming Chief of Stations' conference. Regarding S. 3197, the electronic surveillance bill, Miller said the present plans call for it to be raised on the Senate floor tomorrow, but withdrawn. This means there will be no further action this Congress on the bill. Miller also said the Senate leadership had been notified that the CIARDS legislation must be passed this year and that the Committee was confident that it would be. He said it would be reported from the Committee no later than next Wednesday.

STAT

[redacted]

6. (Unclassified - DFM) LIAISON Met with Tom Connaughton, Senator Birch Bayh's (D., Ind.) designee on the Senate Select Committee on Intelligence. Connaughton said he had received his clearances and would be officially transferred to the staff of the Select Committee within the next week. I asked him about the work of the Subcommittee on Intelligence and the Rights of Americans, which Senator Bayh chairs, and told him I would like to meet with him regarding what support the Agency could give the Subcommittee once the Subcommittee gets underway. Connaughton asked me to provide the first name of the wife of an Agency official whom Senator Bayh had met on his recent trip. Connaughton also said Senator Bayh had found his trip very educational and that the trip had gone very smoothly. I told Connaughton that since this was the first overseas trip of an SSCI member, we would like the opportunity to speak with the Senator about his impressions.

7. (Unclassified - WPB) LIAISON Called Ronald Kienlen, OMB, to inform him the Agency had no problems with the proposed Executive order entitled "Amending Executive Order No. 10973, Relating to Administration of Foreign Assistance and Related Functions; Revoking Executive Order 11501, Relating to Foreign Military Sales; and Providing for the Administration of Arms Export Controls."

8. (Internal Use Only - LLM) AGENCY VISIT Called Clair Hoffman, GAO, and arrangements were made for Hoffman and Mario Petrucelli, also of GAO, to visit NPIC on Monday at 0900 hours to evaluate the effectiveness of our [redacted] program. [redacted] NPIC, was advised.

STAT STAT STAT

[redacted]

10. (Internal Use Only - LLM) LIAISON Accompanied STAT [redacted] OGC, [redacted] IC STAT Staff, to a meeting with Sam Hoskinson, NSC staff, to discuss coordination on requests from the Senate Select Committee on Intelligence. Also in attendance were: Tom Latimer, DOD; Roger Kirk, State Department; an attorney from Justice; John Matheney, NSC staff, and Joseph Dennan, STAT IOB staff. (See [redacted] Memorandum for D/DCI/IC.)

11. (Unclassified - BAA) EMPLOYMENT INTERVIEW Called STAT [redacted] and set up an appointment for [redacted] a STAT constituent from Senator Charles Percy's (R., Ill.) office, for Friday, 17 September 1976, at 10:00 a.m. Scott Cohen, Executive Assistant to the Senator, was advised.

12. (Unclassified - RLB) LEGISLATION Called Mr. Franz Opper, on the staff of the Subcommittee on Consumer Protection and Finance, House Interstate and Foreign Commerce Committee, to check on the status of legislation related to payments by U.S. companies to foreign officials. Mr. Opper confirmed that the Senate had begun floor consideration of S. 3664, Senator William Proxmire's (D., Wis.) foreign payments bill and probably would complete action on the bill tomorrow. Mr. Opper did not know in what form the Senate bill would make it to the House (as a separate bill or as a rider to a House bill). Mr. Opper did state, however, that the Consumer Protection and Finance Subcommittee would be holding hearings on this matter 21 and 22 September.

13. (Unclassified - GLC) ADMINISTRATIVE Called Russ Rourke, White House, and advised him of the meeting of the Steering Group to be chaired by Sam Hoskinson, NSC, tomorrow. He asked that we inform him STAT of any significant items.

[redacted]

JOURNAL

OFFICE OF LEGISLATIVE COUNSEL

Friday - 3 September 1976

1. (Unclassified - SKM) LIAISON Per his request, I sent Jerry Tinker, on the staff of Senator Edward Kennedy (D., Mass.), a copy of the Agency report entitled "Communist Aid to Less Developed Countries of the Free World, 1975."

2. (Unclassified - WPB) LEGISLATION Received a call from Mary Molnar, OMB, who asked if we could have our letter to them by COB today on enrolled bill H.R. 3884, the National Emergencies Act. She said the Administration generally supported the legislation. I called her back later in the day and told her our letter was still with Mr. Knoche and asked if we could get it to her on Tuesday. She said that would be all right, and I gave her the gist of our letter over the phone.

3. (Unclassified - WPB) LEGISLATION Called Jim Jura, OMB, and told him the Agency had no objection to a Department of Commerce draft bill pertaining to intellectual property policy and Government research.

4. (Internal Use Only - LLM) LIAISON In several conversations with Kathy deSibour, NSC staff, I was advised that the decision that is most likely to be made was that no letter will be written by the White House to Representative Leonor Sullivan (D., Mo.) concerning Panama and that a briefing may be offered. deSibour will let us know the final decision which is apparently being made by Bill Hyland, NSC staff. [redacted] STAT
STAT NIO/LA, and [redacted] Assistant to the DDCI, have been advised.

5. (Internal Use Only - LLM) LIAISON Emerson Brown, INR/State Department, called concerning a cable he had been requested to draft on Senator Birch Bayh's (D., Ind.) travel. I explained the background and questioned the necessity for an additional message from State.
STAT [redacted] will follow-up on detail.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

0276-2391

August 24, 1976

LEGISLATIVE REFERRAL MEMORANDUM

TO: Legislative Liaison Officer

(See attached page)

SUBJECT: Commerce's draft bill entitled, "Federal Intellectual Property Policy Act of 1976."

The Office of Management and Budget requests the views of your agency on the above subject before advising on its relationship to the program of the President, in accordance with OMB Circular A-19.

A response to this request for your views is needed no later than c.o.b. September 3, 1976.

Questions should be referred to James Jura (395-3890 ) or to----------( ), the legislative analyst in this office.

James B. Martin for

Bernard H. Martin for
Assistant Director for
Legislative Reference

Enclosures

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National Aeronautics and Space Administration
National Science Foundation
Nuclear Regulatory Commission
Department of Transportation
Arms Control and Disarmament Agency
Council of Economic Advisers
Council on Environmental Quality
Federal Power Commission
Department of Justice
Small Business Administration
Smithsonian Institute
Veterans Administration
Central Intelligence Agency
Civil Service Commission
Department of Defense
Federal Communications Commission
General Services Administration
U.S. Postal Service
Tennessee Valley Authority
Department of the Treasury
U.S. Department of Agriculture
Department of Commerce
Energy, Research and Development Administration
Environmental Protection Agency
Federal Energy Administration
Department of Health, Education and Welfare
Department of Housing and Urban Development
Department of the Interior

DRAFT



EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF SCIENCE AND TECHNOLOGY POLICY
WASHINGTON, D.C. 20500

September , 1976

Honorable Carl Albert
Speaker of the House
of Representatives
Washington, D. C. 20515

and

Honorable Nelson A. Rockefeller
President of the Senate
United States Senate
Washington, D. C. 20510

Dear Mr. Speaker:

Dear Mr. President:

Enclosed are six copies of a draft bill

> "To establish a uniform Federal policy for intellectual property arising from Federally-sponsored research and development; to protect and encourage utilization of such technology and to further the public interest of the United States domestically and abroad; and for other related purposes,"

to be cited as the "Federal Intellectual Property Act of 1976," together with a statement of purpose and need and a section-by-section analysis.

We have been advised by the Office of Management and Budget there would be no objection to the submission of our draft bill to the Congress and further that its enactment would be in accord with the President's program.

Sincerely,

H. Guyford Stever
Director
Office of Science and
Technology Policy

Elliott L. Richardson
Secretary of Commerce

Enclosures

# ROUTING AND RECORD SHEET

SUBJECT: (Optional) OGC 76-4728 8-27-76

FROM: Legislative Counsel
7D35 HQ

EXTENSION [redacted] NO.

DATE 27 August 1976

STAT

| TO: (Officer designation, room number, and building) | DATE RECEIVED | DATE FORWARDED | OFFICER'S INITIALS | COMMENTS (Number each comment to show from whom to whom. Draw a line across column after each comment.) |
|---|---|---|---|---|
| 1. STAT [redacted] Logs & Procurement Div. | 8-27-76 | 2 SEP 1976 | | OMB has requested our comments on this draft bill by 3 September. Please review and let us know if it will have any adverse impact on the Agency. |
| 2. General Counsel 76-179 | | | | |
| 3. | | | | |
| 4. | | | | |
| 5. | | | | |
| 6. Legislative Counsel 7D35 HQ | 3 SEP 1976 | | | 1 to 6. |
| 7. STAT Attn: [redacted] | | | | No adverse impact on our Agency operations. |
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STAT [redacted]
Office of Legislative Counsel